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No. 83/59

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TO COUNTY ASSESSORS:

APPLICABILITY OF THE BUSINESS INVENTORY EXEMPTION
TO RETURNABLE CONTAINERS, AND DEFINITION OF CONTAINERS
AND CONTAINER MATERIALS

Property Tax Rule 133 specifies that business inventories exempt from taxation include "... containers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein." We are periodically asked how the foregoing language applies to transactions involving returnable items, such as soft drink bottles, bottled water containers, beer kegs, drums, plastic or wooden rigid delivery cases, and pallets. The questions are, typically, whether pallets and rigid delivery cases are "containers" within the meaning of Rule 133, and what significance, if any, "deposits" have in the determination of whether title to containers or container materials passes to the purchaser of the product.

Containers and Container Material

Rule 133 does not offer any examples of items which are not to be classified as containers. However, the limited description of containers and container materials offered in the rule--kegs, bottles, cases, twine, and wrapping paper--should be considered indicative as to the types of containers that are eligible for the inventory exemption, namely, packaging materials that hold, enclose, or include products.

Most pallets and rigid delivery cases are portable platforms that are used to transport products from one location to another. A carton (container) of products may be loaded onto a pallet at the time of manufacture, but the carton is likely to be removed from the original pallet and loaded onto other pallets during the various phases of manufacture, storage, transportation, and distribution. Since the primary use of pallets and rigid delivery cases is to facilitate transportation and handling of groups of products rather than containment of products as Rule 133 contemplates, such items are not normally containers within the meaning of the rule.

Pallets and rigid delivery cases can be containers, however. Bricks, concrete blocks, and other masonry items are commonly placed on pallets (are not otherwise contained by packaging materials) at the time of manufacture and stay on those pallets until they are "consumed" by the bricklayer. When used in this manner, the pallet or delivery case is the primary container of the product and therefore is eligible for the inventory exemption if title to the container passes to the purchaser of the product.

Passage of Title

If it is determined that the (returnable) item is a container within the meaning of Rule 133, the item is eligible for exemption only if it is held for sale, i.e., if, upon transfer, title to the item passes to the purchaser of the product. We offer the following guidelines to assist you in deciding whether or not title passes to the purchaser of the product.

1. Written Terms

In general, title provisions in a written contract provide the clearest indication as to whether ownership remains with the seller or passes to the purchaser of the product. However, a contract specifying that title remains with the seller until final payment, but upon final payment title passes to the purchaser, constitutes a sale with the seller retaining bare legal title only for purposes of financial security.

2. Deposit Amount versus Cost or Value of Containers

In matters involving income tax, federal courts have held, generally, that requiring a deposit amount: (a) in excess of cost indicates a sale; and, (b) lower than cost indicates a deposit (not a sale). However, we do not believe that the relationship of the deposit amount to cost or to the current value of a container is necessarily indicative of the merchant's or customer's intentions regarding title to the container. In some cases, the merchant may charge a high deposit (in excess of cost) to encourage the customer to return the container, and a low deposit may be charged when the merchant doesn't really want the container returned. In other cases, such as the soft drink industry, the deposit amount is set on an industrywide basis, so the merchant cannot control the deposit amount regardless of whether title is intended to pass. A review of the merchant's policy regarding the deposit amount may or may not indicate whether title to the container is intended to pass when the deposit is paid.

3. Sales Tax

The exclusion of sales tax reimbursement in a billing for a returnable container and its contents is not sufficient evidence of a transfer or non-transfer of title to the container because many such transfers are exempt from that tax (Section 6364, Revenue and Taxation Code). The inclusion of sales tax reimbursement on the container is indicative of a title transfer regardless of any policy of the seller concerning refunds on returns.

4. Distinctive Marking or Construction

If the container is distinctly marked as the property of the merchant, or if the container is constructed in a unique way to identify it as the property of the merchant, a deposit transaction is indicated. In some

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cases, however, the distinctive marking and construction identifies only a brand name but does not identify the owner. For example, a soft drink bottle may be readily identifiable as a particular brand of soft drink but does not identify the bottler, distributor, or retail merchant; therefore, the distinctive marking or construction does not identify whether a deposit arrangement or a sale is intended.

5. Accounting

The merchant's accounting system may indicate whether a sale or a deposit is intended. If the containers are sold, the merchant should record the transactions as sales (or as "other revenue") and depreciation should not be taken on containers that have been "sold" to customers (the "sold" containers should be deleted from the merchant's asset accounts). If, however, the merchant records the transaction by crediting a deposit (liability) account and continues to record depreciation on the containers, intent to reserve title is indicated.

6. CONDITIONS OF RETURN

If the merchant places no limitation (except damage) on the return of a container for full refund of deposit, a sale is indicated. However, the imposition of a demurrage or rental charge after a specified time indicates that the merchant intends to retain title to the container after delivery to the customer.

If the consumer may return the container for refund to any merchant who deals in the product, then the person in possession has effective title to the container. For example, a consumer of soft drink beverages may return the empty container to the place of purchase or to any other vendor of that brand of soft drink. To put it another way, retailers, distributors, and bottlers are willing to redeem the deposit without regard to the origin of the bottle. This practice indicates that bottlers, distributors, and retailers do not exercise any rights of ownership once the bottle is delivered to another. Therefore, reusable soft drink bottles are (typically) held for sale by such merchants.

All the foregoing guidelines, where applicable, should be considered when determining whether title to returnable containers is or is not intended to pass to the purchaser of the product.

Please contact Charlie Knudsen of this division if you have questions or comments regarding this letter.

Sincerely,



Verne Walton, Chief
Assessment Standards Division